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IN THE

Supreme Court of the United States

VERIZON COMMUNICATIONS, INC., *et al.*,
Petitioners,
v.
FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA,
Respondents.

JUL 23 2001

WORLDCOM, INC., *et al.*,
Petitioners,
v.
VERIZON COMMUNICATIONS, INC., *et al.*,
Respondents.

FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA,
Petitioners,
v.
IOWA UTILITIES BOARD, *et al.*,
Respondents.

AT&T CORP.,
Petitioner,
v.
IOWA UTILITIES BOARD, *et al.*,
Respondents.

GENERAL COMMUNICATION, INC.,
Petitioner,
v.
IOWA UTILITIES BOARD, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

REPLY BRIEF ON THE MERITS OF SPRINT CORPORATION IN SUPPORT OF PETITIONERS FEDERAL COMMUNICATIONS COMMISSION AND UNITED STATES OF AMERICA

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PRELIMINARY STATEMENT

Pursuant to Supreme Court Rules 24.4 and 25.3, Respondent Sprint Corporation ("Sprint") respectfully submits this Reply Brief on the Merits of Sprint Corporation in Support of Petitioners Federal Communications Commission ("FCC") and the United States of America.[1]

ARGUMENT

I. THE FCC's SELECTION OF A PRICING METHODOLOGY BASED ON THE MOST EFFICIENT REPLACEMENT COST DOES NOT VIOLATE THE ACT.

A. The Telecommunications Act Of 1996 Does Not Mandate Recovery Of Historical Costs.

The ILECs generally repeat the same arguments made in their petitioners' brief in challenging the FCC's "most efficient replacement cost" methodology ("Rule 505(b)(1)") for pricing network elements ("UNEs") under the Telecommunications Act of 1996 ("Act"). The ILECs claim that the Act's wholesale pricing provision and the term "reasonable profit" in Section 252(d)(1)(B) demonstrate that historical costs are required; accordingly, they argue, the FCC's forward-looking "most efficient replacement cost" methodology is unlawful because it does not provide for their historical costs. BellSouth Br. at 15; Qwest Br. at 16-17.

The Act's wholesale pricing provision does not implicitly or explicitly endorse either a historical or forward-looking cost model. *See* Sprint Resp't Br. at 24. The wholesale price

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[1] Separate opposition briefs were filed by a group of incumbent local exchange carriers ("ILECs") (*see* Brief for Respondents BellSouth, SBC, Verizon, and USTA) ("BellSouth Br.") and (*see* Brief for Respondent Qwest Communications International, Inc.) ("Qwest") ("Qwest Br."). Except where noted, this reply brief addresses the arguments raised in both briefs.

is based on the ILEC's retail tariff—which state commissions could determine based on a forward-looking cost methodology or using the ILEC's historical costs. *Id.* The wholesale pricing provision is thus neutral on the issue. Nor does Section 252(d)(1)'s reference to a "reasonable profit" support any claim that the Act compels the use of historical costs. *Id.* at 19-20. As the Eighth Circuit succinctly stated, "[a] 'profit' can be made whether a historical cost or a forward-looking cost methodology is used." *Iowa Utils. Bd. v. FCC*, 219 F.3d 744, 752 (8th Cir. 2000) ("*IUB II*") (FCC Pet. App. 13a).

The ILECs also contend that the Act's provision for pricing the transport and termination of traffic, Section 252(d)(2), further demonstrates that the Act requires historical costs. BellSouth Br. at 15. That provision, like the wholesale pricing provision, does not endorse a particular cost methodology, and the FCC concluded that the pricing of transport and termination under Section 252(d)(2) "should be based on the same cost-based standard" as the pricing provisions for network elements and interconnection in Section 252(d)(1). JA 439-441 (¶¶ 1054-1056). This argument, therefore, circles back to the same path and again demonstrates that the Act's UNE pricing provision is ambiguous.

Qwest argues that if Congress intended for network element prices to be based on the cost of the most efficient network, "it could have, and would have, used language to that effect." Qwest Br. at 16. This analysis misses the mark. Congressional silence on the precise cost methodology to be used empowers the expert agency to make that determination. As this Court held, "Congress is well aware that the ambiguities it chooses to produce in a statute will be resolved by the implementing agency." *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 397 (1999) ("*IUB I*"). If Congress intended to prohibit the FCC from using particular methodologies to implement the Act's pricing requirements,

it would have legislated with more precision. Instead, Congress used the ambiguous terms "cost" and "just and reasonable." This Court has long held that a statutory requirement of "just and reasonable" rates allows an agency to select either a forward-looking or a historical cost methodology. *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944). *See also IUB II*, 219 F.3d at 751-52 (FCC Pet. App. 11a) (holding that "cost" is an ambiguous term); *Capital Network Sys., Inc. v. FCC*, 28 F.3d 201, 204 (D.C. Cir. 1994) (a statutory requirement of "just and reasonable" rates has long been understood to be ambiguous and to afford "substantial deference" to the implementing agency); Sprint Pet'r Br. at 13-20.

The ILECs also argue that the language in Section 252(d)(1) requiring UNE rates to be "based on the cost . . . of providing the . . . network element" necessarily refers to an ILEC's existing network. Thus, they contend, the reference to "cost" must mean the ILEC's historical costs to build its network. BellSouth Br. at 14-15; Qwest Br. at 15. This misconstrues the statutory language. By focusing on the "cost of . . . providing" the network element, the statutory language directs the inquiry to the economic costs resulting from the new entrant's use of the network element today and not the original price paid by the ILEC when the network was first built. Rather than base the price of network elements on obsolete or inefficient equipment that no one would purchase, the FCC's most efficient network rule reasonably measures the "cost of . . . providing" the UNE based on what the ILEC or any other carrier would pay in the marketplace today to provide the same functionalities. When properly read in full context, therefore, the statutory language not only allows for, but supports, use of a forward-looking methodology based on the least cost, most efficient technology available.

The ILECs attempt to demonstrate that the Act requires a historical cost methodology through a hypothetical example

involving shipbuilding. They posit that if Congress required Newport News Shipbuilding ("NNS") to build a carrier, and Congress promised to pay the cost of providing the carrier, the Defense Department could not refuse to pay the costs NNS necessarily incurs and instead pay what it hypothesizes would be the costs if the whole shipyard were rebuilt from scratch. BellSouth Br. at 16. This analogy is flawed and only underscores the entrenched monopoly viewpoint of the ILECs. The Act does not require the ILECs to construct whole new networks. It only requires that they share existing elements of those networks based on rates that replicate a competitive marketplace. TELRIC properly measures those rates based on what it would cost an ILEC today to provide the UNE functions using the least cost, most efficient technology. Any actor facing competition would be required to price its offerings based on the same considerations, and not simply based on whatever costs it would like to pass on to its customers. While it may be difficult for the ILECs to adjust to this competitive approach, Congress certainly intended to create such an environment under the Act.

Finally, the ILECs rely on selected portions of the legislative history as support for the use of historical costs. Qwest Br. at 16; BellSouth Br. at 16 n.13. The cited legislative history makes no reference to any particular measure of cost. Indeed, the very same Senate Report cited by the ILECs states that "the State may not use or require a rate of return or other rate based proceeding to determine the cost of an unbundled element." S. Rep. No. 104-23, at 21 (1995). This language was ultimately incorporated into Section 252(d)(1)(A)(i), which expressly precludes any reference "to rate-of-return or other rate-based proceeding . . ." in establishing UNE prices. Because these kinds of proceedings typically use an ILEC's historical costs, one must infer that Congress did not intend for UNE prices to be based on historical costs.

B. The FCC's Selection Of A Cost Methodology Based On The Most Efficient Replacement Technology Was Reasonable And Rule 505(b)(1) Should Be Reinstated.

1. Rule 505(b)(1) Simulates The Real World Costs To A New Entrant In A Competitive Environment.

The ILECs contend that Rule 505(b)(1) will not measure cost accurately because a new entrant would never be able to acquire a least cost, most efficient network "in the real world." They argue that telephone companies do not replace all of their equipment instantaneously, but instead use "anticipatory retardation" to replace equipment over time. They also contend that their ability to implement new, efficient technologies is constrained by "path dependency," which limits their choices because of the need to ensure compatibility with existing brands of equipment.[2] BellSouth Br. at 26-29; Qwest Br. at 31-33.

The ILECs' claims are based on the faulty premise that new entrants must bear the cost of the ILECs' prior strategic choices. The FCC elected to measure the cost of providing UNEs by examining what a new entrant would pay in the marketplace today to replace the functions at issue with efficient substitutes that can be used consistently with the location of the ILEC's existing wire centers. Even if it can be assumed that an ILEC chose not to deploy the most efficient equipment available because of "path dependency," in a competitive market the ILEC still would be forced to price its services against a competitor using such equipment. The

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[2] Given the fact that ILECs account for an overwhelming share of the demand for new telephone equipment, it can be reasonably assumed that equipment vendors already consider "path dependency" concerns when designing their new products in order to maximize demand. The ILECs' "path dependency" concerns, therefore, are likely more theoretical than real.

ILEC's UNE prices would thus mirror its pricing behavior in the retail market. The FCC's choice of a methodology that incorporates these principles is certainly "within the bounds of the reasonable." *IUB I*, 525 U.S. at 395; *Chevron U.S.A., Inc. v. Natural Res. Def. Council*, 467 U.S. 837, 865 (1984).

The ILECs further claim that the FCC's cost methodology assumes a market for network elements when none exists. BellSouth Br. at 19-20. Because no market exists, they contend, it is a theoretical exercise to try to calculate a forward-looking rate for UNEs. *Id.* This argument wrongly presumes that other cost methodologies—such as ones based on historical costs—are less theoretical than a forward-looking cost methodology. As shown in Sprint's earlier briefs, regulators have increasingly found forward-looking cost methodologies to be more reliable and practical than historical cost models. *See* Michael K. Kellogg *et al.*, *Federal Telecommunications Law* § 9.2 (1st ed. 1992) ("In practice, rate of return regulation usually culminates in poor regulation of cost, with prices allowed to float upward."); Sprint Resp't Br. at 23. The FCC also made a reasoned determination that TELRIC could be implemented based on the proven experience of the state commissions. JA 334-336, 381 (¶¶ 631, 681). That determination has been confirmed by the successful use of TELRIC—including Rule 505(b)(1)'s "most efficient replacement cost" component—by state commissions around the country.

The ILECs similarly contend that "no rational new entrant would enter" the market with a most efficient network on the terms posited by the FCC. BellSouth Br. at 28. They assert that a rational new entrant would price UNEs at a level above the most efficient replacement cost—demanding a higher rate of return by charging prices well above TELRIC during the time it had a competitive advantage. *Id.* at 29; Qwest Br. at 33. They believe that the ability to gain a price advantage is the key incentive to use a new technology and that the FCC

erred in assuming that an "instantaneous" price reduction would occur. Qwest Br. at 33.[3]

The FCC was not attempting to "simulate a theoretically perfect market through regulation," as the ILECs wrongly suggest. *Id.* at 21. Rather, the FCC selected a methodology that it determined would best replicate competitive market conditions. At the same time, the FCC sought to ensure that the rates eventually produced by that methodology would encourage new entrants to build competing facilities without stifling competition from the outset. JA 383-384 (¶ 685). The agency concluded that TELRIC "give[s] appropriate signals to producers and consumers and ensure[s] efficient entry and utilization of the telecommunications infrastructure." JA 333 (¶ 630). Rule 505(b)(1)'s network configuration requirement is a reasonable and necessary component of that methodology. In contrast, the FCC determined that the use of historical costs would force competitors to pay for the existing inefficiency of the ILECs' networks and would not "ensure the efficient investment decisions and competitive entry . . . contemplated by the 1996 Act." JA 399 (¶ 705). The agency thus concluded that use of the ILECs' preferred methodology, not TELRIC, would discourage any "rational new entrant" from entering the

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[3] The ILECs argue that this "problem" is not ameliorated by the fact that most interconnection agreements are for three year terms. They contend that technologies and prices are not actually "locked in" for a three year period because the "pick and choose" rule permits CLECs to adopt different prices at any time, and interconnection agreements expire at different times. Qwest Br. at 36; BellSouth Br. at 33 n.25. These concerns are overstated and the ILECs conveniently ignore the fact that most states have conducted generic or consolidated proceedings involving all interested parties to establish industry-wide UNE prices for multi-year periods. *See, e.g., U S W. Communications, Inc. v. Jennings*, 46 F. Supp. 2d 1004, 1009-10 (D. Ariz. 1999); *Southwestern Bell Tel. Co. v. AT&T Communications of the Southwest, Inc.*, No. 97-D-CA-132, 1998 U.S. Dist. LEXIS 15,637, at *8, *33-*34 (W.D. Tex. Aug. 31, 1998).

market. That determination was well-supported and should be affirmed.

2. Rule 505(b)(1) Encourages Facilities-Based Competition.

Qwest contends that Rule 505(b)(1) discourages facilities-based investment by CLECs and thus detracts from Congress' goal of a deregulated local market. Qwest Br. at 23-24. In the "real world," Qwest argues, there is no such thing as a "most efficient, least cost provider." By establishing UNE rates based on this hypothetical provider, Rule 505(b)(1) will "always" make it more attractive for new entrants to lease UNEs rather than to build their own competitive facilities or to lease the same functionalities from a third party. *Id.* at 23-26.

Qwest conveniently ignores the fact that Rule 505(b)(1) incorporates an ILEC's existing wire centers and does not presume the most efficient, least cost provider in the truest sense. The FCC reasonably concluded that including this component as part of the TELRIC cost methodology would provide incentives to new entrants to construct their own facilities, using a more efficient network architecture. JA 383-384 (¶ 685); Sprint Pet'r Br. at 19. Moreover, new entrants have incentives to offer service through their own facilities in order to avoid potential discrimination from the ILEC, *see* JA 299-300 (¶ 307), and to offer innovative services. In order to maintain market share, ILECs will also have incentives to invest in new facilities to compete with innovative services offered by CLECs. By stimulating competition, therefore, the FCC's "most efficient network" rule promotes innovation and does not discourage new investments by ILECs, as Qwest wrongly argues. Qwest Br. at 27.

Qwest's argument also mistakenly assumes that a CLEC offering local service through UNEs will incur lower costs

than a CLEC offering those same services through its own facilities in all cases and at all times. *Id.* at 23-25. There is nothing in the record to support that contention. Nor is there any basis to conclude that a new entrant serving customers through its own facilities would be at a disadvantage with other new entrants serving customers through leased UNEs. Were this the case, there would be a greater percentage of new entrants servicing local customers through leased network elements. Recent FCC data, however, indicates that no single method of competitive entry predominates. Industry Analysis Division, FCC, *Local Telephone Competition: Status as of December 31, 2000* (May 2001).

3. The FCC's Cost Methodology Fairly Compensates ILECs For The Costs Of Providing UNEs.

The ILECs next contend that, by adopting Rule 505(b)(1), the FCC has "knowingly" deprived them of the ability to recover their costs. In particular, they argue that the FCC's treatment of rates of return and depreciation in TELRIC is arbitrary and capricious because it was based on the erroneous conclusion that ILECs "did not yet face significant facilities-based competition in the real world." BellSouth Br. at 30-31. The ILECs claim that the FCC "whipsawed" them by assuming that facilities would be instantaneously replaced while ignoring "the astronomical rates of return and depreciation expenses that would prevail in such a world." *Id.* at 31.

The ILECs' claims are overblown, if not disingenuous. In adopting TELRIC, the FCC used currently authorized rates of return as a starting point and specifically instructed the state commissions to account for the effects of competition on ILECs in setting the depreciation rates and cost of capital. JA 395-396 (¶ 702). Under this approach, "[s]tates may adjust the cost of capital if a party demonstrates to a state commission that either a higher or lower level of cost of

capital is warranted," due to emerging competition and other factors. JA 396 (¶ 702). The FCC thus considered "real world" market conditions and gave the state commissions effective means to adjust for them in establishing UNE prices. Moreover, in the "real world" five years after the Act's passage, the ILECs still maintain over 92% of the local telecommunications market. Sprint Resp't Br. at 34. The ILECs cannot credibly claim that the FCC erred by failing to assume that they faced "significant facilities-based competition."

The ILECs further contend that it was arbitrary and capricious for the FCC to incorporate their existing wire center locations into Rule 505(b)(1) without including other aspects of their existing networks, such as telephone poles. BellSouth Br. at 23; Qwest Br. at 28. In fact, the FCC could have adopted a least cost, most efficient methodology that did not make *any* allowances for the inefficiencies of the incumbents' networks. After fully analyzing several alternatives, however, the FCC determined that incorporating existing wire centers into the cost methodology would provide proper incentives for CLECs to invest in their own facilities without overloading UNE prices with the inefficiencies of an ILEC's network. JA 382-384 (¶¶ 683-685). The agency concluded that this approach was the best way to promote competition and to encourage innovation. That determination was not irrational and should be upheld.

Finally, Qwest alone acknowledges that forward-looking methodologies are permissible, but argues that TELRIC is flawed because it does not base costs on the ILEC's "existing" network. Qwest Br. at 38-41. This approach, as the FCC correctly found, would be essentially an embedded cost methodology and would require CLECs to pay for the existing inefficiencies and obsolescence of the ILEC's network. JA 383 (¶ 684). The FCC also rejected the efficient component pricing rule ("ECPR") advocated by Qwest after finding that ECPR would inflate network element costs by

providing purported "lost profits" to the ILECs. JA 401-402 (¶¶ 708-710). Qwest now suggests that using price caps to determine network element prices would be appropriate. Qwest Br. at 40-41. Price caps are not cost-based. The FCC applied a price cap methodology to calculate access rates in the 1990s, in an attempt to introduce more efficiency incentives in the pricing of access. However, price cap regulation does not eliminate the ILECs' incentives to include inappropriate investments on their books, was largely abandoned by the FCC last year, and, in all events, would not comply with the Act's mandate that UNE prices be cost-based.

C. Rule 505(b)(1) Does Not Raise "Serious Constitutional Questions" Of A Takings Violation.

The ILECs use their challenge to Rule 505(b)(1) to reargue that denying them historical costs would raise "serious constitutional questions" under the Takings Clause. BellSouth Br. at 36. They contend that a forward-looking methodology based on the most efficient replacement cost forces them to "operate at a loss" and that a constitutional problem can only be avoided by adopting a pricing methodology that authorizes recovery of all historical costs. *Id.* at 36-38.

The FCC's adoption of Rule 505(b)(1) does not raise a serious constitutional question, for the reasons shown in Sprint's Brief in Support of the FCC Respondents. Sprint Resp't Br. at 28-43. Most notably, the ILECs have not shown—and cannot show—that the "total effect" of TELRIC rates is so unjust as to be confiscatory. *Id.* at 34-39. Nor can the ILECs avoid the "total effect" test by claiming that state commissions are unable to determine UNE prices because there is no "market" for network elements. BellSouth Br. at 38-39. State commissions have been able to determine the value of the underlying components, labor, and material that make up the network elements, which provides an adequate basis for establishing the rates.

The ILECs also wrongly claim that they were promised "full-cost recovery at a utility rate of return" and that the "breaking" of this promise raises serious takings questions. *Id.* at 40. Yet, this Court has repeatedly held that reasonable investors are not entitled to expect an existing ratemaking scheme to be permanent or to claim entitlement to particular regulatory treatment. *E.g.*, *Tennessee Elec. Power Co. v. Tennessee Valley Auth.*, 306 U.S. 118, 141 (1939); *see also American Trucking Ass'ns, Inc. v. Atchison, Topeka & Santa Fe Ry.*, 387 U.S. 397, 416 (1967). *Cf. New York Cent. R.R. v. White*, 243 U.S. 188, 198 (1917) ("No person has a vested interest in any rule of law, entitling him to insist that it shall remain unchanged for his benefit."). The ILECs have no greater entitlement here. The FCC was authorized to determine the appropriate cost methodology to implement the Act's new regulatory regime. The FCC did not "break" any regulatory promise to the ILECs in carrying out its new mandate from Congress.

II. REQUIRING ILECs TO COMBINE NETWORK ELEMENTS DOES NOT VIOLATE SECTION 251(c)(3) OF THE ACT.

A. Section 251(c)(3) Is Ambiguous.

The ILECs argue that the "plain language" of Section 251(c)(3) forecloses CLECs from leasing UNEs "in combination" unless the network elements are already combined in the ILEC's network. *See* BellSouth Br. at 41-49. They focus solely on the portion of the statute that reads "'in a manner that allows requesting carriers to combine such elements,'" arguing that the "plain assumption" to be drawn from this language is that CLECs themselves must combine the UNEs. *Id.* at 48 (citation omitted). Accordingly, the ILECs contend that Rule 315(c)-(f), which allows CLECs to request UNE combinations where technically feasible, violates the Act.

This Court previously held that the language of Section 251(c)(3) is ambiguous. In reinstating Rule 315(b) as a reasonable interpretation of the statute, this Court ruled that although UNEs may be requested in "discrete pieces," the statutory language "does not say, or even remotely imply, that elements *must* be provided only in this fashion and never in combined form." *IUB I*, 525 U.S. at 394 (emphasis in original). The ILECs attempt to distinguish this Court's interpretation of Section 251(c)(3) by arguing that a rule prohibiting ILECs from separating already combined UNEs "is very different" from a rule requiring ILECs to combine UNEs upon request. BellSouth Br. at 44. In practical effect, however, Rule 315(b) and Rule 315(c)-(f) are opposite sides of the same coin. Both rules are designed to ensure that CLECs are able to obtain UNEs in a manner that permits them to provide competitive local services, as Congress intended. JA 297-298 (¶ 296). Rule 315(b) precludes ILECs from separating already combined UNEs because, as both the FCC and this Court recognized, doing so would unnecessarily increase a CLEC's costs in leasing the elements. This Court concluded that the agency was right to prohibit such an anti-competitive practice. *IUB I*, 525 U.S. at 394-95. Rule 315(c)-(f) accomplishes the same objectives, by requiring ILECs to combine UNEs for CLECs when it is technically feasible to do so. JA 297-298 (¶ 296). The FCC determined that this approach was necessary "given the practical difficulties of requiring requesting carriers to combine elements that are part of the incumbent LEC's network." JA 296 (¶ 294). The agency correctly found that it would be more efficient and reliable for the ILECs who own and control the networks to do the combining. The CLECs, in turn, must pay the ILECs for this service. Absent such a rule, the FCC found, "requesting carriers would be seriously and unfairly inhibited in their ability to use unbundled elements to enter local markets." *Id.* (¶ 293).

Ironically, the ILECs have vigorously objected to providing physical access to their networks in other contexts. *Implementation of the Local Competition Provisions of the Telecomms. Act of 1996*, 15 F.C.C.R. 3696, 3910 (¶ 482) (1999). Under the UNE combinations rule, the ILECs keep control of their networks and are to be fairly compensated for providing combining services to CLECs. The only reason an ILEC would object to the rule under these circumstances is to impede access to UNEs and to increase new entrants' costs. As this Court found in *IUB I*, the FCC was right to prohibit such anti-competitive practices.

The ILECs also attempt to argue that Rule 315(c)-(f) is more akin to the "superior quality" rules that were vacated by the Eighth Circuit than to Rule 315(b). BellSouth Br. at 47. This analogy is flawed. The "superior quality" rules required ILECs to provide interconnection and unbundled access at levels of quality superior to those at which they provided such services to themselves. The Eighth Circuit found that these rules violated the plain language of Section 251(c)(2)(C), which only requires ILECs to provide interconnection that is at least equal in quality and thus "establishes a floor below which the quality of interconnection may not go." *Iowa Utils. Bd. v. FCC*, 120 F.3d 753, 812 (8th Cir. 1997), *aff'd in part and rev'd in part sub nom. AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366 (1999). In contrast, Rule 315(c)-(f) is designed to deter anti-competitive conduct and to ensure meaningful access to an ILEC's existing network facilities. The rule only requires that an ILEC combine UNEs when it is technically feasible to do so. Under this standard, the ILEC is equally capable of combining the UNEs for its own use as it is for a requesting CLEC. Nothing in the rule requires the ILEC to provide any service to a CLEC that is "superior" to what the ILEC can currently provide to itself.

B. The UNE Combinations Rule Is Reasonable And Necessary To Ensure Meaningful UNE Access.

The ILECs next argue that Rule 315(c)-(f) is unreasonable because there is nothing "discriminatory" about requiring CLECs to combine UNEs. BellSouth Br. at 45. As shown, the FCC found to the contrary. Based on the record, the FCC logically concluded that CLECs were not on equal footing with ILECs in obtaining access to the ILECs' networks and that "in practice it would be impossible for new entrants that lack facilities and information about the incumbent's network to combine unbundled elements." JA 296 (¶ 293). As a consequence, the agency determined that CLECs would be unable to offer local services using UNEs on the same level as the ILEC without the combinations rule.

Because Section 251(c)(3) is ambiguous, the FCC was authorized to interpret the statute in light of these policy concerns. *IUB I*, 525 U.S. at 394-95. Experience has proven that these concerns were well-founded. Some ILECs still refuse to provide access to network elements so that CLECs can combine them, effectively defeating the statutory intent. *Implementation of the Local Competition Provisions of the Telecomms. Act of 1996*, 15 F.C.C.R. at 3910 (¶ 482). Attempts by CLECs to obtain access to networks to combine UNEs have also proven to be unworkable and easily obstructed by ILECs. The CLECs' experiences in Colorado are illustrative. The Colorado state commission rejected an ILEC proposal that would "allow" CLECs to combine network elements. The Colorado commission concluded that the proposal "does not provide a reasonable opportunity for CLECs to combine UNEs and thus creates an unnecessary barrier to the development of competition in Colorado." *Investigation and Suspension of Tariff Sheets Filed by U S W. Communications, Inc.*, Docket No. 96S-331T, Decision No. C98-1047 at 13-15 (Colo. Pub. Utils. Comm'n Oct. 1, 1998). One witness explained "that with [an ILEC's] modern

telephone network, loops or trunks are 'moved' electronically through software, and to propose anything different would be to move backwards through time and technology." *Id.* at 12. Based on these and other problems, the Colorado commission found that the ILEC's proposal was "discriminatory," "inefficient," and would cause "unnecessary service disruption to customers." *Id.* at 13-16.

The ILECs also argue that the combinations rule is infected with the same improper analysis underlying the FCC's original Rule 319, which identified the UNEs subject to the access requirements of Section 251(c)(3). In *IUB I*, this Court held that the FCC "did not adequately consider the 'necessary and impair' standards" of Section 251(d)(2) in determining which UNEs must be made available by ILECs. 525 U.S. at 387-88. The Court found that the "necessary and impair" standard meant something more than simply showing that a CLEC would incur higher costs without access to a UNE and that such access was "technically feasible." *Id.* at 390-92.

A determination of which UNEs must be unbundled is different from a determination that ILECs should be required to combine UNEs upon request. The statutory standard prescribed by Congress for the former examines whether particular UNEs are necessary for new entrants to compete. This involves, among other things, consideration of available substitutes for the same functionalities in the marketplace. The statutory duty prescribed by Congress for the latter requires that CLECs be afforded meaningful *access* to the requisite UNEs, once identified. The FCC found that Rule 315(c)-(f) was necessary to ensure such access. Without it, the pro-competitive goals underlying both Sections 251(c)(3) and 251(d)(2) are defeated.[4]

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[4] The ILECs attempt to equate the FCC's concerns over an ILEC's ability to impose wasteful costs on CLECs by forcing them to combine UNEs with the FCC's discredited view that any cost savings to a CLEC

The ILECs cite to the FCC's reference to "technical feasibility" in Paragraph 296 of the *Local Competition Order* as evidence that the agency's analysis of Rule 315(c)-(f) was tainted by the same analysis underlying Rule 319. A fair reading of the agency's discussion proves otherwise. The FCC was reasonably concerned that "network reliability and security factors" may make it technically infeasible for an ILEC to combine UNEs in certain circumstances, even when the individual elements must be made available on an unbundled basis. The agency's provision for this practical possibility in no way undermines the general conclusion that the combinations rule is necessary both to afford CLECs meaningful access to UNEs and to prevent discriminatory practices by ILECs.

The ILECs also wrongly claim that the FCC "acknowledged" that its "technical feasibility standard for additional combinations 'is consistent with the [FCC's] *method* . . . adopted to identify unbundled network elements.'" BellSouth Br. at 46 (citing Paragraph 295 of the *Local Competition Order)* (emphasis added). This again takes the agency's discussion out of context. In the quoted paragraph, the FCC explained that the combinations rule is consistent with the agency's general definitional approach to determining what constitutes a "network element," which may include several parts. JA 297 (¶ 295). As stated by the agency:

> Under our method, incumbents must provide, as a single, combined element, facilities that could comprise more than one element. . . . [F]or example, . . . if the states

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satisfied the "necessary and impair" standard under Rule 319. BellSouth Br. at 49. This argument is equally strained. The combinations rule is designed to ensure that CLECs have meaningful access to UNEs *and* to prevent ILECs from imposing "wasteful" costs. Either objective would support the rule and this Court already found that protecting CLECs from "wasteful" costs was a reasonable basis for Rule 315(b). *IUB I*, 525 U.S. at 395.

> require incumbent LECs to provision subloop elements, incumbent LECs must still provision a local loop as a single, combined element when so requested, because we identify local loops as a single element in this proceeding.

Id. This Court upheld the FCC's "method" of determining which equipment and features of an ILEC's system constitute "network elements" under Section 251(d)(2). The Court found that the agency's approach was "eminently reasonable," particularly in view of "the breadth of [the Act's] definition" of a "network element." *IUB I*, 525 U.S. at 387. The same deference should be afforded to the FCC's determinations underlying the combinations rule.

Finally, the ILECs' reliance on *GTE Service Corp. v. FCC*, 205 F.3d 416, 424 (D.C. Cir. 2000) is misplaced. In that case, the D.C. Circuit evaluated whether particular aspects of the FCC's collocation rules complied with the "necessary" standard prescribed in Section 251(c)(6). The D.C. Circuit upheld many of the FCC's collocation rules as reasonable under *Chevron*. For example, the court upheld a rule that prohibited ILECs from charging new entrants the entire cost of site preparation and required the ILECs to allocate the costs based on the space actually used by the particular CLEC. The court found that this rule was "a reasonable way to ensure that LECs do not impose prohibitive requirements on new competitors and thus kill competition before it ever gets started." *Id.* at 427. The D.C. Circuit's reasoning supports a similar finding that Rule 315(c)-(f) is "a reasonable way" to ensure that new entrants can compete in the local telecommunications market by having meaningful access to network elements.

C. Review Of The Combinations Rule Was Not Waived.

The ILECs contend that this Court should not address the validity of Rule 315(c)-(f) because the challenge was not

preserved in *IUB I*. This argument ignores subsequent history. Although this Court did not review Rule 315(c)-(f) in its decision, the Eighth Circuit on remand ordered the parties to address "whether or not, in light of the Supreme Court's decision, this court should take any further action with respect to . . . § 51.315(c)-(f) . . . ." *Iowa Utils. Bd. v. FCC*, Nos. 96-3321 *et al.*, Order at 2-3 (8th Cir. June 10, 1999). The Eighth Circuit then reviewed its prior determination and upheld its vacation of Rule 315(c)-(f) *on the merits*. *IUB II*, 219 F.3d at 758-59 (FCC Pet. App. 26a-29a).

This Court granted *certiorari* on "[w]hether 47 U.S.C. [§] 251(c)(3) prohibits regulators from requiring that incumbent local telephone companies combine certain previously uncombined network elements when a new entrant requests the combination and agrees to compensate the incumbent for performing that task." *Verizon Communications, Inc. v. FCC*, 121 S. Ct. 877 (2001). The question presented goes to the merits of the combinations rule and is based on the Eighth Circuit's most recent decision. *Cf.* Sup. Ct. R. 19.4 ("If the Court orders that the case be briefed or set for argument, the parties shall be notified and permitted to file briefs."). It borders on the frivolous to argue that the issue was waived under these circumstances.

The ILECs cite to *Communist Party of the United States v. Subversive Activities Control Board*, 367 U.S. 1 (1961) in support of their waiver argument. *Communist Party* involved a challenge to an agency order on a procedural ground that was not raised in the first appeal. The Court found that it would be improper to allow a party to gain an advantage as a result of procedural gamesmanship. *Id.* at 30-31. The question presented here, in contrast, involves a substantive issue that affects the entire telecommunications industry, was reconsidered on the merits by the Eighth Circuit on remand, and has been accepted for review by this Court. Moreover, review of the question by this Court will resolve a conflict

between the courts of appeals over the lawfulness of the combinations rule under Section 251(c)(3). *See* WorldCom, Inc.'s Pet. at 23-27. No party will be disadvantaged by review of the issue under these circumstances.

CONCLUSION

For the foregoing reasons, Sprint respectfully requests that this Court reinstate 47 C.F.R. § 51.505(b)(1) and 47 C.F.R. § 51.315(c)-(f).

Respectfully submitted,

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